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(1 May 73)

MEMORANDUM

SUBJECT: The Soviet Economy and The Summit

SUMMARY

A lagging economy will be one of Brezhnev's chief concerns when he comes to Washington. Industrial difficulties, particularly those encountered in the effort to boost productivity, continue to require a more intensive use of advanced technology. This year's grain outlook is uncertain, and will remain so for several months, but the USSR is clearly going to require substantial imports in the years ahead. The US is a major source--although not the only source--of help on both counts.

Brezhnev's economic policy is part of a larger strategy which he has developed as his own personal power has grown. For the domestic economy, his program calls for greater sustained attention to consumer needs. In domestic politics, it includes the preparation of a new constitution which may carry his name. Abroad, it requires a reasonably stable world environment in which, without ignoring opportunities to advance Soviet interests, the USSR can seek the economic help it needs and, at the same time, try to limit China's diplomatic gains.

Brezhnev can satisfy his immediate economic needs without much reference to Washington; machinery, grain, and credits are freely available commercially, and the US needs to export. But he has taken on a further commitment to improve official economic relations as well. Thus he will be anxious to assure himself that the Administration still intends to fight for MFN, that it means thereafter to push through the US-Soviet trade agreement, and that its attitude on credits is forthcoming.

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Beyond this, Brezhnev will want to push his idea of a new form of economic relations, in which US capital and technology are applied to Soviet natural resources in large-scale, long-term projects. This approach has many advantages for the USSR, which, in addition to foreign financing, would get much-needed help in developing remote areas as well as guarantee for itself large hard-currency earnings. Brezhnev will not expect to conclude any such deals in Washington, but he will press for a joint formal endorsement of this approach in order to open the way. He could probably be brought to pay some price to obtain these objectives.

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DISCUSSION

It is now beyond doubt that Brezhnev is serious about making changes in Soviet economic policy. The success of his programs, and his own position in Moscow, will depend in part on what can be worked out with the US on such matters as grain sales, technology, credits, and MFN. This paper discusses how Brezhnev views the future of the Soviet economy and particularly those issues which involve the US. Although many of these issues are of long-run concern, this paper considers them from the short-run standpoint of how they might bear on the summit.

The exhortations of 1971's Party Congress about improving the consumer's lot have proven to be more than rhetoric. The drive for technological progress is a firmly fixed priority--as indeed it must be if industrial growth is to be sustained at a satisfactory rate. The evidence of a policy shift is plentiful. To cite the most prominent data:

- The Soviets bought 29 million tons of foreign grains last year, primarily to support their ambitious livestock program.
- They are buying again this year, and may have already contracted for nearly eight million tons.
- They are negotiating to import a lot more Western technology.
- Far from stressing the time-honored goal of autarky, they are now saying that self-reliance is a luxury no nation can afford.

Brezhnev's economic line is part of a larger policy conception which goes under the name of "developed socialism." This is a broad view of the direction Soviet society should

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take over the long run. It appears to be the program which he would like history to associate with his name and he is designing it to contrast with Stalin's austerity and Krushchev's irresponsibility.

--Its main feature appears to be the stress on progressing more evenly in all economic sectors.

--It involves a long-run economic plan running to 1990.

--It calls for writing a new Soviet constitution that would at a minimum codify the expanded material gains of the people since the last constitution.

The indications are that Brezhnev would like to enshrine this entire program at the next Party Congress in 1976, when he will be almost 70.

Certain obvious problems arise. Brezhnev hopes for enough economic growth to make a good, sustained showing. He would like to keep military spending from rising significantly in order to concentrate more of the nation's resources on the civilian sector. Arms control agreements could help to prevent such an escalation. Without them, the Soviets will have to make harder decisions, of a kind which are certain to have an internal political dimension.

Foreign policy is closely related. Brezhnev's program requires a reasonably stable world environment. Crises and tensions would both increase the pressures for more military spending and put at risk the economic relations on which Soviet plans will increasingly depend.

This does not require that Soviet foreign policy be passive, or that it make one-sided concessions in important issues. It leaves plenty of room for a forward diplomacy in Europe, for example, or the cultivation of new political

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opportunities in, say, the Arab world. But it does bar a deliberate reversion to a policy of intimidation, and it does commend a steady search for areas of agreement in order to maintain a general environment of cooperation. In this connection, it is significant that Soviet writings have begun to recognize explicitly that small allies and clients can draw great powers into unwanted and even dangerous political conflicts.

The USSR's Current Economic Problems

Brezhnev comes to the summit with an unusually poor economic year behind him. By the end of 1972 the goals of the Ninth Five-Year Plan (1971-75) were in jeopardy as problems in industry and agriculture forced a number of adjustments in economic policy.

The Soviet Union's central economic problem is that it has passed out of the phase of its history in which it can rely on "extensive" growth--based upon larger and larger increments of labor and fixed capital. It must now depend on "intensive" growth--productivity gains--based mainly on technological progress but also on innovations in organization. Since the present Soviet leaders assumed power they have tried to spur productivity growth by trying out internal reforms and by exploiting foreign experience. Over the last few years, they have come to put more reliance on the second of these courses.

The other major economic problem is the need to improve the lot of the Soviet consumer. This has required altering the traditional pattern of Soviet economic growth in favor of sectors which are less efficient and more costly to develop. Brezhnev's commitment to expand meat production is the most striking example of this new policy. His livestock program has created a demand for grains that Soviet farms cannot satisfy even in a year of good weather. From 1966 to 1970, the government drew heavily on its reserve stocks, but when a bad harvest struck in 1972, it brought to a head a growing dependence on Western grain that above-average harvests in 1970 and 1971 had disguised. First Deputy Premier Polyansky took the rap in a demotion, but Brezhnev's prestige was tarnished.

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The new crop got off to a poor start, but if all goes well from this point forward, the Soviets could harvest a record crop of 153 million tons (compared with 134 million tons in 1972). Even with this record crop, however, the USSR would still need to import about 15 million tons of grain to maintain the livestock program. On the other hand, if they have another poor harvest this year--140 million tons or less--imports of grain could run as high as last year. After that, our best estimate is that they will need at least 30 million tons of grain imports over the two years beyond FY 1974.

The Economy and the Summit

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Although the facts of life are pushing the Soviets toward a greater dependence on the West, they remain wary.

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As the Soviet leaders realize how their economic dependence on the West is growing, they must consider how much to rely on US sources. Some will argue against this reliance and will cite the opportunity it would provide for the US to demand political concessions. They might also argue that it makes good commercial sense to bargain multiple suppliers off against each other and that, in any event, their needs could be met by other suppliers as well.

Others, while sharing these concerns, believe that in many cases the US is the best supplier in economic terms and that the dependence will be mutual, since US industrialists and farmers are looking for markets. These leaders will also maintain that concentrating on the development of US-Soviet economic relations furthers their political interests vis-a-vis the US and acts as a counterweight to growing relations between the US and China.

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While Brezhnev has burned no bridges, he is clearly impressed with how well equipped the US economy is--in both industrial and agricultural terms--to meet Soviet needs. He also seems inclined to make Soviet-US relations the centerpiece of his foreign policy and would probably like to reinforce the political/diplomatic side of this relationship with major economic links. His recent success in reshuffling the Politburo will in any event strengthen his hand.

Industrial Technology

25X1 The line Brezhnev took last month [redacted] 25X1 [redacted] clearly indicates what he would like to get out of the summit on this front. He used that meeting to propagandize about the need to look beyond the mere exchange of goods to a new era of huge developmental projects which would apply US capital and advanced technology to Soviet natural resources. Cooperation on this scale, he said, would require political decisions of the sort which he and President Nixon reached, for example, on arms agreements, at the Moscow summit. He can be expected to press hard for a ringing endorsement, in the Washington summit communique, for this type of economic cooperation.

In more specific terms, the proposal to exploit Siberian reserves of oil and gas with Western technology and investment resources is a good example of the type of project which interests the Soviets. It is attractive on several counts--acquisition of important technology, development of remote natural resources and large and guaranteed hard-currency earnings. Brezhnev would be delighted with a summit endorsement of the proposed LNG venture, particularly in the wake of a US energy policy statement which seemed to diminish its chances by stressing domestic sources. He would be even more anxious for approval if the US were seen to be dickering with China on energy, e.g., discussing joint exploration of the China Sea and other Chinese continental shelves. Although Brezhnev appreciates that LNG is a long-term proposition which must clear many hurdles, he would probably be willing to give something in return for a Presidential endorsement now.

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US Government control over exports of advanced equipment and technology has been greatly attenuated as a result of the new US policy on unilateral controls and the shortening of the multilateral (COCOM) control list. Most of the industrial equipment and technology that the USSR might want is no longer controlled. Brezhnev knows that, for current items of advanced technology, the USSR can for the most part deal directly with US firms. The larger projects which he wishes to stimulate, however, would require both government approval and government financing or guarantees. He hopes to use the summit to develop a climate of expectations that these will be forthcoming.

The Grain Question

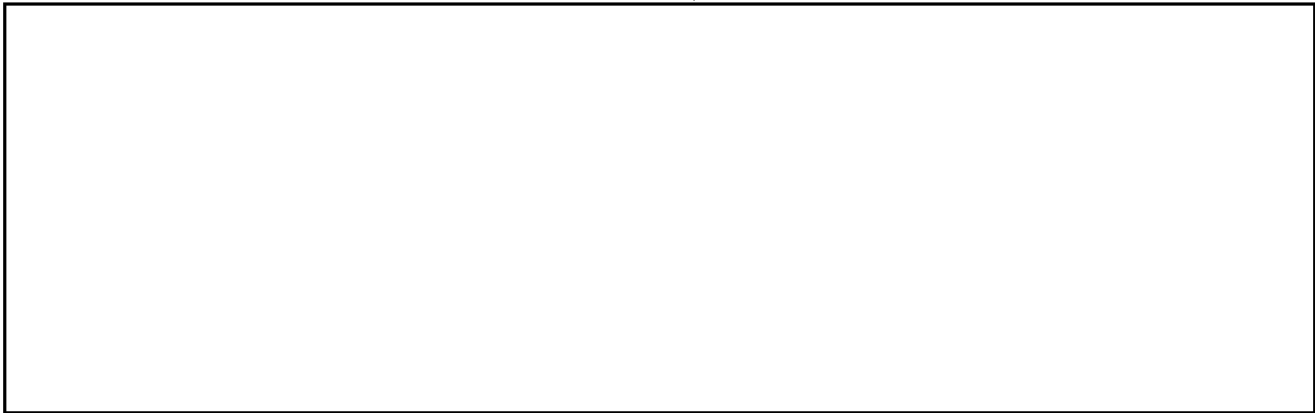
As things now stand, the larger the Soviet grain requirement, the larger the share that would have to come from the US. For example, if 12 million tons were needed, about half would have to come from the US; if 20 million tons were needed, perhaps two-thirds would have to be purchased here. However, if pressed by high prices or other circumstances, the Soviets could cultivate other suppliers, particularly over the longer run. Long-term contracts, for example, could encourage substantially higher production in Canada, Argentina, and Australia.

The Soviets have generally avoided long-term contracts for commodities such as grain where world supplies and prices might fluctuate substantially. However, based on their recent experiences in arranging for the purchase, shipping and internal distribution of 29 million tons of foreign grain, the Soviet leadership might be persuaded to enter a long-term grain contract with the US. Possible advantages might be a more orderly marketing process and a lower purchase price. Brezhnev would have had to clear this deal with his colleagues in advance.

The worse the harvest prospects, the greater the chance that Brezhnev will approach the summit interested in a long-term agreement under favorable terms, and the more useful it will be in maintaining his own political position. Even a

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good recovery from last year's low would not completely remove Brezhnev's interest in a long-term agreement, although he might be in less than a hurry. By mid-June, he will have a fairly clear view of harvest prospects in the western half of the country, but he will know less about the later-ripening grain areas of the east.



Trade Conditions

The Soviets see MFN and the extension of Exim financing as important milestones in expanding US-USSR trade relations. MFN is a prestige item--tariffs are not a significant hindrance on those items which loom large in Soviet exports to the US. It is important for its symbolic value in the bilateral relationship, as the Soviets have shown by their willingness to adjust their emigration policy. Having paid once for MFN in this fashion, they would be loath to do so again, but they probably would pay some small price if necessary to re-secure Administration backing.

Some \$500 million in Exim credits are now available to the Soviets, of which \$200 million are already committed, and they would like more. These credits are not commercially crucial for any save the largest projects, since the USSR has made itself eligible for larger Eurodollar credits and US bank credits. Drawing back on Exim credits would have only a small economic effect, but the Soviets would probably see considerable political significance in this action at this stage of the game.

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Conclusions

The USSR realizes that the US, because of its private enterprise system and its own need to increase exports, cannot easily control economic relations with the USSR in a way which would provide gains in other fields. The Soviet Union can buy large grain tonnages and sign contracts with US manufacturers with little reference to Washington. Nevertheless, the over-all stance which Washington adopts on economic matters will have considerable impact in Moscow.

Brezhnev has innovated not only in his acceptance of the need for closer economic relations with the West, but also in his stand that the West, as a matter of policy, will encourage this process. His present political position, in the wake of last week's Central Committee plenum and Politburo changes, is stronger than ever. Nevertheless, he has gone bail for a certain amount of Western, and particularly US, good will. Given the priority of economic difficulties in the range of Soviet problems, he needs some success on this front. A summit which did not promise increased US economic cooperation in this area--which is free of the alliance aspects that complicate so many other matters--would be a disappointment which could weaken his position later if his conduct of policy encountered other setbacks.

Brezhnev will therefore be seeking visible evidence that the Administration is working hard to get MFN approved, that it intends thereafter to push the trade agreement to completion, and that it is forthcoming on credits. He will be on the lookout for a more specific deal, such as the LNG project, which can be endorsed. Most of all, however, he will be seeking an official blessing for the concept of long-run joint endeavors which combine US capital and technology with Soviet natural resources.

He will profess to believe that the US has an equal requirement for such expanded relations, and that the USSR has other options. But Brezhnev can probably be brought to see that he needs some evidence of economic progress at the summit more than the US does. Just what price he might be willing to pay would depend on the total negotiating environment and the immediate state of play in other problem areas.

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ACTION	DIRECT REPLY	PREPARE REPLY
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COMMENT	FILE	RETURN
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Remarks:

Distribution on the attached memo (17 May 73)
as follows:

Orig. & Copy 2 - DCI for Mr. Kissinger
3 - E. W. Proctor
4 - A. W. Marshall, NSC

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XC-(NSC) Special Memo

FOLD HERE TO RETURN TO SENDER

FROM: NAME, ADDRESS AND PHONE NO.

DATE

2 May 73

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MEMORANDUM FOR: Dr. Henry A. Kissinger

Attached is the memorandum which you requested on Soviet economic problems that Brezhnev will have in mind as he approaches the summit.

James R. Schlesinger
Director of Central Intelligence

Attachment:
OCI No. 1675/73
Copy No. 1

1 May 1973
(DATE)

MEMORANDUM FOR: A. W. Marshall
National Security Council

Here is a copy of the paper which
Henry Kissinger requested.

Jim Schlesinger sent it down to
him on 1 May.

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Attachment:
OCI No. 1675/73
Copy No. 4

DB/OCI

2 May 1973

(DATE)

18 April 1973

NOTE FOR: Director/OER
Director/OCI

The Director relayed the following request this morning:

Dr. Kissinger wants a paper on the Soviet short term economic prospects. The emphasis should be on:

- the problems the Soviets are facing and which of them are exploitable by us.
- how will these problems affect (or inhibit) Soviet foreign policy.

The Director said that the paper should be about 10 to 15 pages. It should not deal with or overly discuss such items as GNP, etc. I.E., as untechnical as possible.

Although no firm date was given, it should be done before 30 April. Since this really does not involve any additional research, I think you should have a draft ready for me to review by 25 or 26 April.

Ed Proctor